

Message Text

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ACTION EA-14

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FM AMEMBASSY MANILA

TO SECSTATE WASHDC 2066

C O N F I D E N T I A L SECTION 1 OF 2 MANILA 3366

E.O. 11652: GDS

TAGS: MARR, RP

SUBJECT: EMBASSY DRAFT ARTICLE XII PROPOSAL: BACKGROUND

REF: (A) STATE 130889 (B) MANILA 3367

BEGIN SUMMARY: HISTORY OF MBA INCOME TAX PROBLEMS REVIEWED RE CIVILAIN EMPLOYEES, PARTICULARLY THOSE OF LONG-TERM EMPLOYEES AT SUBIC WHOM PHIL BUREAU OF INTERNAL REVENUE (BIR) CONSIDERS RESIDENTS OF PHILIPPINES. PROBABLE GOALS OF BIR IN NEGOTIATION OUTLINED; USG COUNTER-PROPOSALS OUTLINED. IT NOT CLEAR WHETHER BIR VENDETTA SUPPORTED BY MALACANANG. IT NOT UNLIKELY PRESIDENT MARCOS CAN BE PERSUADED TO DISCARD OR MODIFY VARIOUS HARD-LINE BIR POSITIONS. IT SHOULD BE RECOGNIZED, HOWEVER, THAT IF MARCOS OVERRULES BIR, THERE LIKELY TO BE COSTS. GOP AWARE MAINTENANCE OF BROAD TAX EXEMPTIONS IS SIGNIFICANT U.S. GOAL IN MBA NEGOTIATION. END SUMMARY.

1. THE 1971-72 MBA WORKING GROUP TALKS ON TAXATION MATTERS TOOK PLACE IN AN ATMOSPHERE DOMINATED BY THE BUREAU OF INTERNAL REVENUE (BIR) OF THE DEPARTMENT OF FINANCES' EFFORTS TO EXTEND ITS WRIT IN ALL DIRECTIONS AND TO PROVE TO PHILIPPINE MEDIA AND THE PUBLIC THAT THE BIR WAS AGGRESSIVELY DEFENDING PHILIPPINE INTERESTS.

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DEPT. WILL RECALL THAT BIR CAMPAIGN WAS TO INCREASE

TAX REVENUES SIGNIFICANTLY FROM ALL SECTORS WHERE TAXES APPEARED TO BE UNDER-DECLARED OR NON-REPORTED; CAMPAIGN HAS BEEN INTENSIFIED SINCE DECLARATION MARTIAL LAW. BASIC BIR AIM IS TO INCREASE REVENUE FROM THE BASES AND SPECIFICALLY TO ESTABLISH THE TAX LIABILITY OF AMERICAN EMPLOYEES AT US BASES WHO HAD BEEN BORN IN THE PHILIPPINES OR HAD RESIDED IN THE PHILIPPINES PRIOR TO THEIR EMPLOYMENT. BIR HAS ARGUED THAT SUCH PERSONS DEMONSTRABLY WERE NOT "RESIDING IN THE PHILIPPINES BY REASON ONLY OF SUCH EMPLOYMENT" WHICH IS THE TEST SET FORTH IN PARAGRAPH 2 ARTICLE XII (INTERNAL REVENUE TAX EXEMPTION) OF THE 1947 US-RP MILITARY BASES AGREEMENT. IN ANY CASE, BIR HAS ARGUED FURTHER THAT THE CITED PARAGRAPH ONLY SPOKE TO THE QUESTION OF LIABILITY TO PAY INCOME TAX AND THAT US CIVILIAN PERSONNEL WERE NOT EXEMPTED FROM THE REQUIREMENT TO FILE A PHILIPPINE INCOME TAX RETURN.

2. EVENTUALLY TEST CASES OF INCOME TAX EVASION WERE BROUGHT AGAINST 17 LONG-TERM US CIVILIAN WORKERS AT SUBIC. A NUMBER OF THE 17 PERSONNEL HAD EITHER BEEN BORN IN THE PHILIPPINES BEFORE THE WAR AND REPATRIATED TO THE UNITED STATES FOR SHORT PERIODS AFTER THE WAR AND RETURNED TO THE PHILIPPINES TO BE EMPLOYED AT THE BASES OR WERE NATURALIZED AMERICAN CITIZENS OF PHILIPPINE DERIVATION. SOME OF THE 17 ALSO WERE MARRIED TO PHILIPPINE CITIZENS, AND HAD PURCHASED LAND IN THE PHILIPPINES THEMSELVES OR IN THEIR WIFE'S NAME. ALL HAD BEEN STATIONED IN THE PHILIPPINES FOR EXTENDED PERIODS.

3. THE TEST CASES WERE DECIDED AGAINST THE AMERICAN DEFENDANTS IN MAY 1973 AND WERE APPEALED. THE DECISION AGAINST THE DEFENDANTS SPECIFICALLY DECLARED THAT, NOTWITHSTANDING MBA EXEMPTION FROM PAYMENT OF PHIL INCOME TAX, THERE NO EXEMPTION FROM REQUIREMENT FOR FILING INCOME TAX RETURNS. FURTHER, THE DEFENDANTS WERE FOUND TO BE RESIDENT ALIENS FOR INCOME TAX PURPOSES. IN OBITER DICTA, ONE LOWER COURT JUDGE ALSO DECLARED THAT ALL INCOME EARNED IN PHILIPPINES WAS PHILIPPINE SOURCE INCOME.

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4. THEREFORE, THE TASK OF US NEGOTIATORS WILL BE TO TAKE ACCOUNT OF THESE RULINGS IN WORKING OUT NEW LANGUAGE THAT WILL CLARIFY THE QUESTION OF RESIDENCY FOR TAX PURPOSES, ESTABLISH AN EXEMPTION FOR THE REQUIREMENT OF FILING INCOME TAX RETURNS, AND ALSO REINFORCE THE FACT THAT US GOVERNMENT SALARIES AND EMOLUMENTS ARE NOT PHILIPPINE SOURCE INCOME. THE POSSIBILITY EXISTS, OF COURSE, THAT THE COURT OF APPEALS MAY OVERTURN THE VER-

DICT OF THE LOWER COURTS ADVERTED TO IN THE PREVIOUS PARAGRAPH, BUT EMBASSY DISCUSSIONS WITH THE SECRETARY OF JUSTICE AND THE SOLICITOR GENERAL HAVE REVEALED THAT THE COURT MIGHT FEEL CONSTRAINED TO SUPPORT THE LOWER COURT'S FINDING OF FAILURE TO FINE, INDEED, THE SOLICITOR GENERAL AND SECRETARY OF JUSTICE SUGGESTED TO EMBASSY OFFICERS THAT THE MOST USEFUL WAY OUT OF THE DILEMMA CREATED BY THE ACTIONS OF BIR WOULD BE TO MAKE THE WORKING OF ARTICLE XII MORE SPECIFIC WITH REGARD TO RESIDENCE AND EXEMPTION FROM FILING WHEN MBA NEGOTIATIONS ARE RESUMED.

5. WHEN SUCH NEGOTIATIONS RESUME, INASMUCH AS BIR HAS ARON ITS TEST CASE, IT CAN BE ANTICIPATED THAT VERY TOUGH NEGOTIATIONS WILL TAKE PLACE ON THE ENTIRE INCOME TAX EXEMPTION AREA. THE XTEY BIR POSITIONS WILL BE:
A. SALARIES OR EMOLUMENTS RECEIVED BY DEPENDENTS OF MEMBERS OF US ARMED FORCES WORKING OR EMPLOYED ON THE BASES SHOULD BE CONSIDERED INCOME FROM PHILIPPINE SOURCES. (THE REASONING WILL BE THAT SUCH PERSONS ARE NOT RESIDING IN THE PHILIPPINES BY REASON ONLY OF THEIR EMPLOYMENT.)
B. NATIONALS OF THE US WHO WERE BORN/AND/OR WERE RESIDING IN THE PHILIPPINES PRIOR TO CIVILIAN EMPLOYMENT IN THE BASES SHOULD BE SUBJECT TO PHILIPPINE INCOMETAXES. (AGAIN, BIR REASONING WILL BE THAT SUCH PERSONS ARE NOT RESIDING IN THE PHILIPPINES BY REASON ONLY OF SUCH EMPLOYMENT.)

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ACTION EA-14

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-07 H-03 INR-10 L-03

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FM AMEMBASSY MANILA

TO SECSTATE WASHDC 2067

C O N F I D E N T I A L SECTION 2 OF 2 MANILA 3366

C. WITH REGARD TO EXEMPTIONS FROM POLL TAXES, RESIDENT TAXES, IMPORT OR EXPORT DUTIES, TAXES ON PERSONAL PROPERTY, ETC., BIR WILL ARGUE THAT US NATIONALS WHO WERE BORN AND/OR RESIDING IN THE PHILIPPINES PRIOR TO EMPLOYMENT TO SERVICE ON THE BASES ARE NOT ENTITLED TO ANY EXEMPTIONS FROM THE ABOVE TAXES. (FYI: THIS IS A MURKY AREA. LOCAL-HIRES FOR YEARS HAVE HAD SUCH PRIVILEGES AND HAVE BEEN LARGELY TREATED BY THE BASES IN THE SAME MANNER AS PERSONNEL HIRED OUTSIDE THE PHILIPPINES HAVE BEEN TREATED. THE PHILS HAVE GONE ALONG WITH THIS PRACTICE BUT THEY HAVE CLEARLY INDICATED THEY INTEND TO TRY TO REMOVE LOCAL-HIRE PRIVILEGES AND EXEMPTIONS),

D. BIR WILL ARGUE FOR THE DELETION OF PARAGRAPH 4 OF ARTICLE XII WHICH PROVIDES AN EXEMPTION FROM PHILIPPINE INCOME TAXES FOR US CONTRACTORS. (IT IS PROBABLE THAT BIR WILL RECOGNIZE THE UNIQUE STATUS OF TEC REPS, BUT ALL PREVIOUS INDICATIONS HAVE BEEN THAT BIR OPPOSES CONTINUATION OF EXEMPTION FROM PHILIPPINE INCOME TAXES FOR OTHER US CONTRACTORS.)

E. FINALLY, BIR WILL ADDITIONALLY ARGUE FOR AN ELIMINATION OF ANY EXEMPTIONS WHATSOEVER FOR CONTRACTORS IN ARTICLE XII INASMUCH AS CONTRACTORS ARE SPECIFICALLY MENTIONED ONLY IN PARAGRAPH 4, AND ARE NOT SPECIFICALLY INCLUDED IN THE CLASSES OF PERSONS ELIGIBLE FOR EXEMPTION IN PARAGRAPH 2.

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6. IN EMBASSY DRAFT SUBMITTED SEPTEL HAS PROPOSED WORDING THAT SPECIFICALLY ADDRESSES PROBLEMS WE ANTICIPATE BIR WILL RAISE IN INCOME TAX AREAS. WORDING PROVIDES FOR BOTH EXEMPTION FROM FILING AND PAYMENT OF PHIL INCOME TAX FOR MBA PERSONNEL AND CONTRACTORS. USG SOURCE INCOME MADE EXPLICIT. DRAFT ARTICLE ALSO STATES PERIODS THAT US NATIONALS IN PHILS FOR MBA REASONS WILL NOT BE CONSIDERED AS PERIOD OF RESIDENCE OR DOMICILE FOR TAX PURPOSES. WORDING ALSO PROVIDES OVERALL EXEMPTION FROM ANY REVENUE-PRODUCING CHARGE AND INCLUDES SPECIFIC EXEMPTIONS APPLICABLE TO US CITIZEN CONTRACTOR PERSONNEL. DRAFT MEETS THRUST OF PHIL POSITION ON FIRST IMPORT PERIODS AND EXCLUDES LOCALLY-HIRED PERSONNEL FROM TAX EXEMPTION BENEFITS. TWO SPECIFIC FALLBACK POSITIONS INCLUDED IN FORM OF AGREED MINUTES FOR PARAGRAPH 2 AND PARAGRAPH 3 OF ARTICLE. WE ANTICIPATE NEED FOR AGREED MINUTES ON DEFINITION OF DEPENDENTS IN PARAGRAPH 1 AND ALLOWANCE FOR REPLACEMENT OF PERSONAL PROPERTY AFTER INITIAL IMPORT PERIOD HAS LAPSED.

7. COMMENT: EMPHASIS HAS BEEN PUT IN THE FACT THAT

BUREAU OF INTERNAL REVENUE HAS ESTABLISHED VERY HARD-
LINE POSITIONS ON VARIOUS MBA INCOME TAX ISSUES. IT
IS NOT CLEAR WHETHER MALACANANG SUPPORTS BIR IN MAIN-
TAINING THESE TOUGH POSITIONS. IT IS NOT UNLIKELY THAT
PRESIDENT MARCOS CAN BE PERSUADED TO SIGNIFICANTLY
MODIFY THESE POSITIONS. IT SHOULD BE
RECOGNIZED, HOWEVER, THAT IF MARCOS OVERRULES BIR IN
THIS MATTER THERE WILL BE COSTS. THE FILIPINOS ARE
DOUBTLESS AWARE THAT THE QUESTION OF MAINTAINING
TAXATION EXEMPTIONS UNDER ARTICLE XII IS A SIGNIFICANT
US GOAL AND THAT US NEGOTIATORS COULD COME UNDER FIRE
FROM CONGRESS, THE MEDIA AND THE GAO IF THE MAXIMUM TAX
EXEMPTION POSSIBLE IS NOT RETAINED.
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